ECONOMIC AND SOCIAL SURVEY OF ASIA AND THE PACIFIC 2014

Regional Connectivity for Shared Prosperity

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# SRI LANKA

*Country briefing notes*

## Growth accelerated on consumer spending

- Economic growth accelerated to 7.3% in 2013 from 6.3% in 2012, mainly driven by robust household consumption, which was supported by remittance inflows, eased monetary policy stance, and steady tourism revenue.

- The hotels and restaurants sector advanced favourably, while construction activities benefited from urban housing demand and reconstruction activities in areas that suffered extensive damage during the internal conflict that ended in 2009.

- The economy is projected to maintain a high growth momentum, at 7.6% in 2014. Some of the contributing factors include an increase in investment particularly public infrastructure projects, a favourable macroeconomic environment, and a stronger global economy recovery.

## Inflationary pressure softened but still high

- The annual inflation rate moderated to a still high level of 6.9% in 2013, from 7.5% in 2012. Moderating international food and fuel prices helped to mitigate the imported inflation.

- About one-third of cereals consumed in Sri Lanka need to be imported, so domestic food prices are highly vulnerable to global price developments.

- High food inflation tends to hurt the poor harder, as they spend proportionally more on food purchases, especially cereals and vegetables.

- To contain food inflation, substantial wastage of agricultural produce needs to be minimized by improving the supply chain logistics and setting up cold storage and processing facilities. It is also essential to enhance agricultural productivity by ensuring that small-holder farmers benefit from modern technologies.

## Current account deficit narrowed

- Merchandise exports resumed a positive growth in 2013 after a modest contraction in 2012. The pickup was mainly fuelled by strengthening import demand from developed economies. Export items are still generally low value-added and concentrated in textiles and garments.

- Workers' remittances and tourism income have increased steadily in recent years. The current account deficit narrowed to 3.9% of GDP in 2013, from 6.7% of GDP in 2012. In addition to the export rebound, measures to curb gold imports also played a role.

- Despite the recent improvement, the current account shortfall remains large. This is reflected in a notable national savings-investment gap. Low domestic savings are partly linked to a lack of public savings, as evident in persistent fiscal deficits. Enhancing private and public savings would help sustain the country's investment level and reduce its external account vulnerability.

## Macroeconomic policy developments

- Partly owing to a healthy growth performance in 2013, the fiscal deficit moderated to 5.9% of GDP, from close to 7% of GDP in both 2011 and 2012.

- Monetary policy was also accommodative amid some softening of inflation and fragile external demand. In 2013, policy interest rate cuts of 100 basis points were made. The cash reserve ratio was also lowered.

## Medium-term development challenges

- Reducing large fiscal and external current account deficits and improving the business environment are among the Government's policy priorities. The public debt level is close to 80% of GDP. Sizeable public external debt also makes the country subject to greater exchange rate risk.

- Like in Bangladesh and India, income inequality has deepened in Sri Lanka over the past few decades. Public spending to support the poor and the vulnerable groups in the population could be further enhanced.

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